



SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78223; File No. SR-NASDAQ-2016-013]

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 2, to Require Listed Companies to Publicly Disclose Compensation or Other Payments by Third Parties to Board of Director's Members or Nominees

July 1, 2016

I. Introduction

On March 15, 2016, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to require listed companies to publicly disclose compensation or other payments by third parties to board of director’s members or nominees for director. The proposed rule change was published for comment in the Federal Register on April 5, 2016.³ On May 18, 2016, Nasdaq filed Amendment No. 1 to the proposal.⁴ On May 20, 2016, the Commission extended the time period within which to approve the proposed rule change, disapprove the

¹ 15 U.S.C.78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 77481 (Mar. 30, 2016), 81 FR 19678 (“Notice”).

⁴ See Letter to Brent J. Fields, Secretary, Commission, from David Strandberg, Associate Vice President, Nasdaq dated May 18, 2016.

proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁵ On June 30, 2016, Nasdaq withdrew Amendment No. 1 and filed Amendment No. 2 to the proposal, which replaced and superseded the original proposal in its entirety.⁶ The Commission received eight comments on the proposal by seven commenters, as well as a response

⁵ See Securities Exchange Act Release No. 77879 (May 20, 2016), 81 FR 33571 (May 26, 2016).

⁶ See Letter to Brent J. Fields, Secretary, Commission, from David Strandberg, Associate Vice President, Nasdaq dated June 30, 2016. In Amendment No. 2, Nasdaq clarified, among other things, that: the required disclosure must be made no later than the date on which the relevant company files or furnishes a definitive proxy or information statement (or, if the company does not file proxy or information statements, no later than when the company files its next Form 10-K or Form 20-F); the proposed rule does not separately require the initial disclosure of newly entered into agreements or arrangements, provided that disclosure is made pursuant to the rule for the next shareholders' meeting at which directors are elected; a company must make the required disclosure at least annually; the disclosure requirement encompasses non-cash compensation and other forms of payment obligation, such as indemnification; all references in the proposed rule to proxy or information statements are to the definitive versions thereof; remedial disclosure (when a company newly discovers an agreement that should have been disclosed), regardless of its timing, would not satisfy the annual disclosure requirements; and a company that provides disclosure in the current fiscal year pursuant to the requirement in Item 5.02(d)(2) of Form 8-K would not have to make separate disclosure under the proposed rule, although disclosure under Commission rules would not relieve a company of its ongoing obligation under the proposed rule to make annual disclosure. The amendment also explicitly states that, if a company provides disclosure in a definitive proxy or information statement, including to satisfy the Commission's proxy disclosure requirements, sufficient to comply with the proposed rule, the company's obligation to satisfy the rule is fulfilled regardless of the reason for which such disclosure was made.

Amendment No. 2 also revised the proposal to explicitly permit the required disclosure to be made in an information statement in addition to other ways specified in the proposal; limit the required disclosure to the material terms of agreements or arrangements relating to compensation and payments in connection with a person's board service or candidacy; and permit website disclosure through a hyperlink to another website, provided that the other website is continuously accessible. Amendment No. 2 also added that a foreign private issuer would be permitted to follow home country practice in lieu of the proposal's requirements provided that it complies with the conditions set forth in Nasdaq Rule 5615. In addition, the amendment revised the effective date of the disclosure requirements to thirty days after Commission approval of the proposed rule and included a statement from Nasdaq that it would notify listed companies of the effective date.

to the comment letters from Nasdaq regarding the proposal⁷ This order grants approval of the proposed rule change, as amended by Amendment No. 2.

II. Description of the Proposed Rule Change as Modified by Amendment No. 2

Nasdaq is proposing to adopt Rule 5250(b)(3) to require each listed company to publicly disclose the material terms of all agreements or arrangements between any director or nominee for director on the company's board and any person or entity other than the company relating to compensation or other payment in connection with that person's candidacy or service as a director.⁸ The proposal would require disclosure of all such agreements and arrangements by no later than the date on which the company files or furnishes a definitive proxy or information statement subject to Regulation 14A or 14C under the Act in connection with the Company's next shareholders' meeting at which directors are elected (or, if they do not file proxy or information statements, no later than when the Company files its next Form 10-K or Form 20-F).⁹

The proposal as modified by Amendment No. 2 would require a listed company to disclose

⁷ See Letters to Brent J. Fields, Secretary, Commission, from Andrew A. Schwartz, Associate Professor of Law, University of Colorado Law School, Boulder, Colorado, dated April 25 and 26, 2016 ("Schwartz Letters"); Bobby Franklin, President & CEO, National Venture Capital Association, dated April 26, 2016 ("NVCA Letter"); John Hayes, Chair, Corporate Governance Committee, Business Roundtable, dated April 26, 2016 ("Business Roundtable Letter"); John Endean, President, American Business Conference, dated April 28, 2016 ("American Business Conference Letter"); Marc M. Rossell, Chair, Securities Regulation Committee, Bar of the City of New York, dated May 20, 2016 ("New York City Bar Letter"); Heather C. Briccette, President & CEO, The Business Council of New York State, Inc., dated June 15, 2016 ("NYS Business Council Letter"); Darla Stuckey, President & CEO, Society for Corporate Governance, dated June 27, 2016 ("Society for Corporate Governance Letter"). See also See Letter to Brent J. Fields, Secretary, Commission, from David Strandberg, Associate Vice President, Nasdaq dated June 30, 2016 ("Response Letter").

⁸ See proposed Rule 5250(b)(3)(A).

⁹ See proposed Rule 5250(b)(3). See also *supra*, note 6 for a description of changes made in Amendment No 2 as compared to the original filing.

this information either on or through the company's website or in the definitive proxy or information statement¹⁰ for the next shareholders' meeting at which directors are elected (or, if the company does not file proxy or information statements, in its Form 10-K or Form 20-F). The proposed rule provides that a company would not need to make disclosure, however, of agreements and arrangements that: (i) relate only to reimbursement of expenses in connection with candidacy as a director; (ii) existed prior to the nominee's candidacy (including as an employee of the other person or entity) and the nominee's relationship with the third party has been publicly disclosed in a definitive proxy or information statement or annual report (such as in the director or nominee's biography); or (iii) have been disclosed under Item 5(b) of Schedule 14A of the Act or Item 5.02(d)(2) of Form 8-K in the current fiscal year.¹¹ Such disclosure, however, pursuant to these provisions under Schedule 14A and Form 8-K in (iii) would not relieve a company of its disclosure obligations under the proposed rule.¹²

The proposed rule states that a Company must make the disclosure required by the rule at least annually until the earlier of the resignation of the director or one year following the termination of the agreement or arrangement.¹³ The proposed rule further states that if a Company discovers an agreement or arrangement that should have been disclosed pursuant to the proposed rule but was not disclosed, then the Company must promptly make the required disclosure by filing a Form 8-K or 6-K, where required by Commission rules, or by issuing a press release.¹⁴ However, such remedial disclosure, regardless of its timing, would not satisfy the annual

¹⁰ See supra note 6.

¹¹ See proposed Rule 5250(b)(3)(A).

¹² See id.

¹³ See proposed Rule 5250(b)(3)(B).

¹⁴ See proposed Rule 5250(b)(3)(C).

disclosure requirements under the proposed rule.¹⁵

The proposal further provides that if a company undertakes reasonable efforts to identify all such agreements or arrangements, including asking each director or nominee in a manner designed to allow timely disclosure, and makes the required remedial disclosure promptly if it discovers an agreement or arrangement that should have been disclosed but was not, then the company will not be considered deficient with respect to the rule.¹⁶

The Exchange also proposes to make a change to Nasdaq Listing Rule 5615, which permits foreign private issuers to follow their home country practice in lieu of certain corporate governance requirements of the Exchange, provided that the issuer fulfills the conditions set forth in that rule. Under the proposal, the required disclosure of third-party payments to directors will be included among the rule provisions where a foreign private issuer would be permitted to follow home country practice.¹⁷ To meet the conditions of Rule 5615, a foreign private issuer would be required to submit to Nasdaq a written statement from an independent counsel in its home country certifying that the company's practices are not prohibited by the home country's laws. The issuer would also be required to disclose in its annual filings with the Commission (or, in certain circumstances, on its website) that it does not follow the proposed rule's requirements and briefly state the home country practice it follows in lieu of these requirements.

III. Comments on the Proposed Rule Change and Nasdaq's Response

As previously stated, the Commission received a total of eight comment letters from seven

¹⁵ See id. See also supra note 6.

¹⁶ See proposed Rule 5250(b)(3)(D). The proposed rule also provides that in, all other cases, the Company must submit a plan that satisfies Exchange staff that the Company has adopted processes and procedures designed to identify and disclose relevant agreements or arrangements.

¹⁷ See supra note 6.

commenters.¹⁸ Four commenters expressed general support for the proposal.¹⁹ One of these commenters stated that third-party payment arrangements of the kind covered by the proposal “present numerous problems besides the obvious potential conflict of interest that shareholders should consider in voting for board members.”²⁰ In addition, the commenter believed that “the ability to keep both arrangement and the terms thereof secret provides ‘raiders’ and other types of activists an unfair tactical advantage over the incumbent board members,” and that “if an insurgent candidate is elected to the board, secrecy around that board member's outside compensation can inhibit the effective functioning of the board of directors.”²¹ Echoing similar beliefs, another of these commenters stated that full disclosure of the material terms of third party arrangements with a director is “a necessary element of understanding and assessing the ability of directors and director nominees to fulfill their fiduciary duties.”²² Another commenter stated its belief that “investors need to know if there are compensation arrangements for any director in which an entity other than the listed company is paying for that particular director’s service.”²³

One comment letter stated its aim as ensuring that Nasdaq was fully informed as it considered whether to move forward with the proposed rule change, in view of what it described as the somewhat complex arrangements that can exist when a board member of an issuer is a general partner of a venture capital fund partnership that owns a substantial interest in the issuer and is also a

¹⁸ See supra note 7.

¹⁹ See Schwartz Letters, Business Roundtable Letter, American Business Conference Letter, and Society for Corporate Governance Letter, supra note 7.

²⁰ See American Business Conference Letter.

²¹ Id.

²² See Business Roundtable Letter.

²³ See Society for Corporate Governance Letter.

member or an associate of the venture capital firm that formed the venture capital fund.²⁴ This commenter recommended that Nasdaq clarify the conditions of the exemption in the rule for pre-existing relationships as well as the degree of detail needed in disclosures required by the proposed rule.²⁵

Finally, two commenters recommended that the proposed rule change not be approved.²⁶ One of these commenters indicated uncertainty as to whether the issues addressed by the Exchange's proposal are not adequately covered by existing Commission rules.²⁷ This commenter further believed that the Commission should "promote desirable uniformity in the nature of required disclosures to investors about director compensation arrangements at public companies, without differentiation based on the exchange on which a company's securities are listed."²⁸

The other commenter opposing approval of the proposed rule change, similarly, believed that proposal "may be duplicative" because the Commission already has rules that "may already address the disclosures covered in the proposed rule change."²⁹ This commenter argued that "approving similar rules aimed at the same goal but from a different regulator would make compliance unnecessarily difficult and would not be an efficient use of resources," adding that if more disclosure was required by the proposal than by the Commission's rules, "investors in

²⁴ See NVCA Letter, *supra* note 7.

²⁵ *Id.* The NVCA Letter also noted that potential restrictions on the ability of individuals who receive compensation to serve as a director could adversely affect venture capital firms due to the structure of venture capital funds. See *id.* The Commission notes that this is not within the scope of the Nasdaq proposed rule change.

²⁶ See New York City Bar Letter and NYS Business Council Letter, *supra* note 7.

²⁷ See New York City Bar Letter *id.*

²⁸ *Id.* The commenter cited, in this regard, the Commission's Disclosure Effectiveness Project.

²⁹ See NYS Business Council Letter, *supra* note 7.

Nasdaq-listed companies would be receiving different information on these matters than investors in companies listed on other exchanges, which could lead to confusion.”³⁰ The commenter further argued that the Nasdaq proposal would require companies to “unnecessarily incur costs and expend energy without any meaningful benefit to shareholders.”³¹

In its Response Letter, Nasdaq cited the letters that had been received in support of its proposed rule change, noting that the submitters of these letters shared the Exchange’s view that the proposed disclosures would be meaningful to shareholders and relevant to their investment and voting decisions. In response to the view of opposing commenters that existing Commission regulations may already require the disclosure mandated by the proposed rule, Nasdaq noted that the proposal would not require separate disclosure when disclosure sufficient to satisfy the proposed rule has been made by a company under existing Commission proxy rules. Acknowledging that there are various Commission rules that may, in some circumstances, apply to third party director payments, Nasdaq stated, nonetheless, that the nature, scope and timing of these required disclosures may not in all cases be the same as the disclosure mandated by its proposal.³² Nasdaq averred that it had considered the concerns raised in the comment letters, but believes the proposal as amended adequately addresses them.³³

IV. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national

³⁰ Id.

³¹ Id.

³² Nasdaq cited its proposal’s ongoing annual and remedial disclosure requirements as examples. See supra note 7.

³³ In this regard, Nasdaq specifically mentioned the concerns raised in the NVCA Letter around board service by venture capital board members.

securities exchange.³⁴ In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,³⁵ which requires, among other things, that the Exchange's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and not be designed to permit, among other things, unfair discrimination between issuers.

The development, implementation, and enforcement of standards governing the initial and continued listing of securities on an exchange are activities of critical importance to financial markets and the investing public. Listing requirements, among other things, serve as a means for an exchange to provide listed status only to companies that meet certain initial and continued quantitative and qualitative criteria that help to ensure that fair and orderly markets can be maintained once the company is listed. The corporate governance standards embodied in the listing standards of national securities exchanges, in particular, play an important role in assuring that exchange-listed companies observe good governance practices, including that listed companies provide adequate disclosure to allow investors to make informed investment and voting decisions. The Commission has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, provide greater transparency into the governance processes of listed issuers and enhance investor confidence in the securities markets.

³⁴ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

³⁵ 15 U.S.C. 78f(b)(5).

The majority of the commenters, as described above, were supportive of the proposal and thought it was important to ensure that investors have material information about third party payments to nominees and existing directors. Two commenters, however, requested that the Commission not approve the Nasdaq's proposal.³⁶ The commenters were concerned that the Exchange requirements may be duplicative of Commission disclosure requirements and that disclosure of director compensation is a matter more suited to uniform regulation by the Commission.

The Commission recognizes that there may be some overlap with Commission disclosure requirements. Depending on the facts and circumstances, various provisions under the federal securities laws, such as Items 401(a) and 402(k) of Regulation S-K, Item 5(b) of Schedule 14A, and Item 5.02(d) of Form 8-K, may require disclosure of third party compensation arrangements with or payments to nominees and/or board members.³⁷ We note that it is not unusual for national securities exchanges to adopt disclosure requirements in their listing rules that supplement or overlap with disclosure requirements otherwise imposed under the federal securities laws. For example, notwithstanding the requirements imposed by the federal securities laws to report certain material events shortly after they occur on Form 8-K, national securities exchanges maintain separate, broader disclosure rules that require prompt disclosure of material information.³⁸ These and other disclosure-related listing standards help to ensure that listed companies maintain

³⁶ See New York City Bar Letter and Business Council Letter, supra note 7.

³⁷ In addition to these specific disclosure requirements, information about third party compensation arrangements may be required under other provisions of the federal securities laws which require disclosure of any additional material information necessary to make the statements included in the relevant filing, in light of the circumstances under which they are made, not misleading. See, e.g., Exchange Act Rules 10b-5, 14a-9, and 14c-6.

³⁸ See, e.g., NYSE Section 202.05; Nasdaq Rule 5250(b)(1).

compliance with the disclosure requirements under the federal securities laws and contribute to the maintenance of fair and orderly markets by providing investors with material and current information necessary for informed investment and voting decisions.

The proposal contains certain exceptions to address some of the concerns raised by commenters about overlap with Commission rules. For example, an exception is provided for disclosure of arrangements or agreements that have been disclosed under Item 5(b) of Schedule 14A or Item 5.02(d) of Form 8-K in the current fiscal year.. In addition, in Amendment No. 2, Nasdaq made clear that if, in response to a Commission disclosure requirement, a company provides disclosure in a definitive proxy or information statement sufficient to comply with the proposed rule, such disclosure would also satisfy the company's disclosure obligation under the Nasdaq rule. Further, the proposal permits listed companies, to the extent the disclosure is not otherwise required in a proxy or information statement, to disclose the information on a website, either directly or through a hyperlink. This should help to mitigate any disclosure burden on companies that have already provided the required disclosure in a prior Commission filing because the rule only would require the company to post a link to that filing on its website.

To the extent, there are certain factual scenarios that would require disclosure not otherwise required under Commission rules, we believe that it is within the purview of a national securities exchange to impose heightened governance requirements, consistent with the Act, that are designed to improve transparency and accountability into corporate decision making and promote investor confidence in the integrity of the securities markets.³⁹

³⁹ For example, the Commission has previously determined that exchange listing standards relating to audit committee independence requirements that included heightened requirements beyond those specifically mandated by Rule 10A-3 were consistent with the Act. See Securities Exchange Act Release No. 48745 (Nov. 4, 2003), 68 FR 64154 (Nov.

Concerning the instant proposal, to the extent that it would, in certain situations, provide investors and market participants additional information to make informed investment and voting decisions, we believe it is consistent with the requirements of Section 6(b)(5) of the Act .

Finally, the Commission notes that certain changes and clarifications were made to the proposal by Nasdaq in response to comments. Amendment No. 2 clarified that non-cash compensation includes indemnification and further clarified in the proposed rule language that the material terms of the agreement or arrangement that need to be disclosed are those relating to compensation and not limited to cash payments. Further, Nasdaq amended the rule language concerning an exception to disclosure relating to relationships that existed prior to a nominee's candidacy. That proposed change states that no additional disclosure is required if the prior relationship between the nominee and the third party has been publicly disclosed in a definitive proxy or annual report. The Exchange further clarified in the amended rule language in proposed IM-5250-2 the timing of when the disclosure needs to be made when the disclosure is posted on the Company's website. These changes, among the others made in Amendment No 2, help to clarify the proposal and address some of the concerns expressed by the commenters.

V. Solicitation of Comments on Amendment No. 2

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

12, 2003).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2016-013 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2016-013. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2016-013 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 2

The Commission finds good cause to approve the proposed rule change, as modified by

Amendment No. 2, prior to the 30th day after the date of publication of the notice of Amendment No. 2 in the Federal Register. As noted above, in Amendment No. 2, the exchange clarified various aspects of the proposed rule's applicability and included new provisions that enhance the proposal.⁴⁰ The Commission believes the clarifications in Amendment No. 2 would provide market participants with greater transparency regarding the requirements for listed companies to disclose compensation or other payments by third parties to board of director's members or nominees under Nasdaq's rules. In addition, in Amendment No. 2, the Exchange revised the proposed date of effectiveness of the proposed rule change.⁴¹ The Commission believes this revision will allow listed companies appropriate time to comply with the proposed rule change.

Because Amendment No. 2 provided additional transparency to the disclosure requirements imposed by the proposed rule change, enhanced its provisions, and provided a revised date of effectiveness which will allow listed companies time to comply with the new requirements, the Commission finds good cause for approving the proposed rule change, as modified by Amendment No. 2, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.⁴²

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴³ that the proposed rule change (SR-NASDAQ-2016-013), as modified by Amendment No. 2, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated

⁴⁰ See supra note 6.

⁴¹ See id.

⁴² 15 U.S.C. 78s(b)(2).

⁴³ 15 U.S.C. 78s(b)(2).

authority.⁴⁴

Brent J. Fields,
Secretary.

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⁴⁴ 17 CFR 200.30-3(a)(12).

